Supreme Court, U.S.
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No. 99-2000

In The

Supreme Court of the United States

VIDEO TRAX, INC.,

Petitioner,

v.

NATIONSBANK, N.A.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Put simply, the only question in this case is whether a bad check processing fee charged by a bank to a customer's deposit account constitutes interest for purposes of usury law. Indeed, both the district court (in the first paragraph of the "Analysis and Discussion" section of its final order) and the Eleventh Circuit (which expressly adopted the district court's analysis in its opinion) have specifically recognized that the sole question in this case is whether a one-time, fixed-amount, per item fee charged to Video Trax whenever it wrote a bad check on its account with NationsBank constituted interest under 12 U.S.C. §85, 12 C.F.R. §7.4001(a), and Florida's usury statute. As the district court stated:

> The parties agree that the sole issue for determination is whether the OD fee [i.e., the Overdraft Item Fee on checking accounts charged by the bank for checks drawn in excess of the collected balance in a depositor's account] was really "interest" [pursuant to 12 U.S.C. §85, 12 C.F.R. §7.4001(a), and Florida's usury statute Sections 687.01 et seq.] that, when aggregated with the interest charged on the average daily overdrawn balance, was usurious.

See Petitioner's Appendix B at 11a and Appendix A at 2a.

RULE 29.6 STATEMENT

NationsBank, N.A., n.k.a. Bank of America, N.A., a national association formed under the laws of the United States, is a wholly-owned, direct subsidiary of NB Holdings Corporation, a private company incorporated under the laws of the state of Delaware. NB Holdings Corporation is in turn wholly-owned by Bank of America Corporation, a public company incorporated under the laws of the state of Delaware. To the best of our knowledge, there is no publicly held company that owns 10% or more of Bank of America Corporation's stock.

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STATEMENT OF THE CASE

Plaintiff has sought by this action to radically alter the present fee structure imposed on bank customers when they write bad checks on their checking accounts, a structure that has been approved by all federal banking regulators and employed by virtually all financial institutions in the United States for a substantial period of time. Accepting plaintiff's argument would work a fundamental change in the American banking system and substantially disrupt the regulation of bank fees by the Office of the Comptroller of the Currency. As the OCC itself explained in an *amicus* brief to the Eleventh Circuit, plaintiff's argument – that the bad check fee charged for an overdraft item in a deposit account is a subterfuge to exact a usurious rate of interest – is contrary to established federal regulations that govern bank fees. A complete copy of the OCC's brief is appended.

A. The District Court's Statement Of Facts As Accepted By The Eleventh Circuit

The final order of the district court very concisely states the pertinent, undisputed facts of this case. In essence, the judge explains that NationsBank has a unified bad check processing system which, pursuant to the account agreement, immediately posts to the bank's general ledger accounts a due and owing, one-time, fixed-amount, per-item bad check processing fee for each and every check in any amount presented to the bank in excess of a customer's account balance. This fee is imposed whether or not such a check is ultimately honored or returned and regardless of the name ultimately

assigned to the fee when it is subsequently posted on the individual customer's account statement, that is, whether it is called an "OD" fee for checks that are paid or an "NSF" fee for checks that are not paid and returned. As the judge's summary of undisputed facts clearly establishes, the fee does not bear any of the normal indicia of "interest."

The Eleventh Circuit's opinion accepts this factual rendition of the district court by expressly noting that the "facts and procedural history are set out in the district court's opinion." *See* Petitioner's Appendix A at 2a. NationsBank, therefore, similarly adopts the district court's statement of facts in its entirety. That statement is reproduced in Petitioner's Appendix B at 4a-8a.

B. Video Trax's Factual Misstatements

Video Trax attempts to paint a different factual picture than the district court by the use of artful omission. Video Trax gives this Court only bits and pieces of the discovery taken in this case, ignoring undisputed evidence which demonstrates the faulty nature of its claim. Each of the objective facts presented by Video Trax (although not its characterizations of those facts) may be true, but the overall picture created by Video Trax's selective omission of other relevant facts is totally inaccurate. That is, Video Trax has created a statement of facts by adding a "spin" to the facts it has carefully selected out of the body of discovery in this case. The undisputed facts of record in this case, however, establish that the district judge correctly entered summary judgment in favor of

NationsBank and against Video Trax and that the Eleventh Circuit correctly affirmed. The following is a point-by-point reply to the most egregious factual omissions and mischaracterizations contained throughout Video Trax's brief:

(1) Misstatements based upon selective consideration of facts in the record:

(a) Plaintiff's Assertion: *The account agreement did not provide for a flat fee whenever a check exceeded the account balance.*

Video Trax ignores the express provision in the NationsBank Deposit Agreement making fees applicable to its checking account pursuant to the bank's Business Schedule of Fees. This itemized fee schedule clearly provides a single, all-inclusive fee for any type of check in excess of a customer's account balance. It reads: "Overdraft check, insufficient funds, unavailable funds, per item . . . $27." Quite clearly, a portion of the NationsBank agreement ignored by plaintiff *does* provide for a flat fee.

(b) Plaintiff's Assertion: *The NSF and OD charges are separate designated fees.*

Video Trax ignores the unequivocal, unrebutted testimony of Karin Hirtler-Garvey, the Comptroller of NationsBank, that the bad check processing fee is an up-front, uniform, per item processing fee automatically posted to the bank's general ledger immediately upon determination by the bank's computer that a customer's account does not have sufficient funds to cover a check presented for payment. In her deposition, she specifically states:

Q. Are there certain accounts that NSF fees are booked into versus overdraft fees or are they in some manner booked together?

A. I think they are together.

Q. Do you know why they are booked together?

A. We don't think of them differently from an accounting perspective.

Q. Why not?

A. Because they are the same. They are a fee and the fact is that someone wrote a check and didn't have money to cover it.

. . . .

Q. Do you know at what point in the processing of an overdraft check the overdraft fee is assessed?

A. Immediately when the system does the math [i.e., compares the amount of the check to the customer's account balance] and determines this has been an overdraft the fee is charged.

The deposition testimony of David Duvall, a NationsBank officer upon whom plaintiff relies, is precisely the same:

Q. Paragraph 6, you say, "The NSF/OD per item fee set forth in the business schedule of fees as described above is a check-processing fee charged whenever a check or other debit is presented to the bank that creates a potential overdraft situation." How do you know that?

A. Because we handle the OD and NSF items exactly the same way.

> Q. Well, you charge it based on different criteria, correct?
>
> A. The path that the check takes is exactly the same. The handling of that check is exactly the same, which is why the fee is the same.

The facts set forth in this testimony establish that the NSF and OD fees are not "separate designated fees," as the plaintiff argues, but, rather, the same bad check processing fee which is posted to a single general ledger account at the very outset of processing a bad check. The names "NSF" and "OD" are added afterward for the purpose of identifying on customer account records (as opposed to the bank's general ledger) whether a particular bad check was honored or returned. Video Trax has focused solely on the end of the bad check handling process and ignored all that goes before. Video Trax has the tail wagging the dog.

Video Trax is simply playing a name game in an attempt to create a distinction that does not really exist. Whether labeled as an NSF fee or an OD fee, a bad check processing fee is actually a processing fee charged by banks for handling a check written and presented for payment that exceeds the balance in the customer's deposit account, which fee is charged regardless of whether the item is honored or returned. Video Trax is attempting to take advantage of the fact that there is no consistency in the naming of this fee by different banks and organizations. The OCC refers to it as the "NSF fee" or "bad check processing fee." It could also be called an overdraft check processing fee, an overdraft item ("OD") fee, a non-sufficient funds ("NSF") fee, an NSF/OD fee, a presentment fee, or some other name. (Unfortunately, and

even more confusingly, some of the same terms are also used in an entirely different context to describe fees charged by a creditor when a credit card holder attempts to pay the monthly statement with a bad check.)

In this case, NationsBank's business schedule of fees applicable to Video Trax's checking account simply identifies the bad check processing fee in a single line item as: "Overdraft check, insufficient funds, per item. . . . $27." The bank labels this fee an "OD" or "NSF" fee on customer deposit account records (as opposed to general ledger accounting records) merely to identify for the customer and the bank the decision made by the bank on how the item was ultimately treated (i.e., honored or returned). There is in fact, however, only one bad check processing fee.

(c) Plaintiff's Assertion: *The process by which the OD fee was assessed is functionally different than the process where an NSF fee was assessed.*

In making this assertion, plaintiff ignores the indisputable fact that NationsBank has only one, integrated bad check processing system which charges exactly the same fee for processing each and every bad check, regardless of whether it is honored or returned. NationsBank's treatment of all bad checks begins at the same starting point. All bad checks then flow through the same system. Indeed, the whole point of the system, which employs a single exceptions processing computer program known as Vector 5, is to allow bank officers to evaluate on a daily basis each bad check for each customer for the singular purpose of reaching an ultimate decision on whether to return or honor each such check.

It is not actually possible to strip away those parts of the system involving return (NSF) checks and to focus only on overdraft (OD) checks that are honored (i.e., to disintegrate the system) as Video Trax has attempted to do.

At the very outset of this integrated processing system, the bank imposes one, flat, per-item processing fee for each bad check right up front. During the entire process, the fee for any one bad check can, at any time, readily be labeled, or relabeled, as "NSF" or "OD" until a final decision is made on whether the check for which the fee has been imposed is honored or returned at the end of the governmentally mandated clearing time. The fact that the fee is given a different name when the bad check is honored (OD) than the name used when the bad check is returned (NSF) does not convert the processing fee into interest. Plaintiff is engaged in nothing more than a game of semantics, picking out only those portions of the system containing the words "overdraft" or "OD" and ignoring the existence of the rest of system. Plaintiff attempts to elevate the importance of names over substance.

(2) Mischaracterization of facts about the bad check processing system:

(a) Plaintiff's Assertion: *A flow chart shows that the fee is assessed on bad checks only after the credit decision is made, thereby making it a fee charged "in connection with" an extension of credit.*

Video Trax has failed to read the entire flow chart. The chart (which, in any event, its author – Roland Rodriguez – testified was prepared for purposes entirely unrelated to the issue of when or how an overdraft fee would be charged) in fact shows on its face that the bad

check fee is always charged whether the check is paid or returned. This is clearly demonstrated in the decision box at the bottom center of the flowchart into which *all* bad check decisions flow and in which the ultimate question "Item Paid?" is posed.

Moreover, the chart actually uses the same terminology whether the check is honored or returned. The chart indicates that if the answer to this question ("Item Paid?") is "yes," i.e., if the bad check is honored, then an "OD fee is assessed." But the chart also indicates that if the answer is "no," the item is not honored, i.e., if the bad check is returned, then, nevertheless, the same "OD fee is assessed." That is, the flowchart uses the same "OD fee" terminology regardless of whether the item is returned or honored. There is no reference whatsoever in the flow chart to an "NSF fee." This undermines the semantics game being played by Video Trax.

It is true, of course, as Rodriguez admitted in his deposition, that when NationsBank ultimately posts the bad check processing fee to a customer's account record (after it has already posted the fee to its general ledger as an earned fee), it labels the fee "NSF" on the customer's records if the bad check was returned and "OD" if the bad check was honored. This allows the bank and the customer to quickly identify whether the bad check for which the processing fee was charged was honored or not. Rodriguez was not, however, attempting to resolve the lack of consistency in nomenclature for bad check processing fees utilized not only by banks but also by the OCC and other federal bank regulators. Indeed, his use of names on the chart accurately reflects the reality that

there is, in fact, only one bad check processing fee involved in this case.

(b) Plaintiff's Assertion: *The bank's process for deciding whether to pay an item includes a matrix that permits the extension of an "unofficial line of credit," thereby allowing a check to be processed without any additional cost to the bank.*

This is yet another mischaracterization by Video Trax. It is premised upon plaintiff's false labeling of the matrix as a "credit-scoring model" designed to increase the number of checks honored to increase fee income. Such description, however, ignores the only testimony directly on point, given by Duvall, that the matrix is part of the bad check processing system and not part of any credit analysis. Indeed, as Duvall explains, the factors considered by the matrix are not anywhere near sufficient to constitute a credit model or to serve as a valid basis for making loan decisions. No reasonable banker would make traditional loan decisions on such limited information. In fact, the most obvious aspect of the matrix is that it starts recommending dishonor of a customer's bad checks after only one or two prior bad checks *in any amount* have been allowed to clear in the course of a year. (The Video Trax account was an unusual situation in which the branch manager frequently overrode the matrix because of repeated pleas by its owner, Rene Elalouf, to accommodate him, a fellow tenant in the same shopping center.) In fact, all bad checks go through the same, expensive review system. The bank recovers this expense by charging a fee to the customers who submit bad checks to the bank. No bad check is exempt from the

process or from the initial imposition of the bad check fee. It is true Duvall made the point in his deposition that there is no difference in cost to process a bad check whether it is ultimately honored or returned, i.e., there is no additional cost to process a check that is honored (an "OD" check) than there is to process a check that is returned (an "NSF" check). This does not, however, mean that processing a bad check is costless. It simply means that the processing cost is the same whether the check is honored or returned.

Video Trax's mischaracterization ignores the observations in the report published by Earnings Performance Group, upon which plaintiff places such great reliance, that (1) the matrix was primarily laborsaving because bank officers were in fact already allowing a certain number of bad checks to clear as an accommodation to customers, thus saving the effort of having to constantly reverse return decisions while not excessively increasing the number of items ultimately honored; and (2) the extra fee income would be generated not so much because more checks were honored (the same fixed fee being charged whether the check is returned or honored) but rather because bank officers would be required to affirmatively act to *waive* the fee instead of allowing automatic up-front blocking of the fee as in the past.

Video Trax's repeated reference to the matrix as an "unofficial line of credit" is taken from this EPG report, a document prepared by consultants to NationsBank, not by the bank itself (which report, tellingly enough, is entitled "*Noninterest* Income Project"). Plaintiff does attribute the phrase to EPG, but in a carefully ambiguous

way (by reference to "a report generated for NationsBank"). Video Trax is fully aware that no one at the bank (and no testimony in this case) accepts EPG's characterization of the matrix, and, indeed, Video Trax knows that the bank's representative in this case, Duvall, expressly takes issue with the characterization because, as he testified, a bank line of credit would only be created by consideration of many more factors than contained in the matrix. Once again, Video Trax is playing with words to reach an unjustified and incorrect conclusion.

(c) Plaintiff's Assertion: *Pay-to limits are not part of the bad check processing system, thus making them like a line of credit.*

Once again, Video Trax's characterization rests upon a false assumption. The "pay-to" limit, which NationsBank also refers to as an "officer assigned limit," is a part of the bad check processing system just as much as the matrix, all of which, of course, costs the bank substantial sums of money to maintain and operate. By use of the pay-to option, a relationship officer can instruct the computer used in the bad check processing system to make a tentative decision to pay bad checks for a certain customer up to a certain limit, after which the computer will tentatively decide to return such items. The purpose is to allow relationship officers greater flexibility than allowed with the matrix. Each tentative pay-to limit decision by the computer, like each matrix decision, requires subsequent evaluation by a bank officer on a daily basis, and any computerized recommendation can be overridden by the appropriate bank officer. The pay-to limit can be eliminated by a relationship officer at any time, especially because there is no agreement with the customers to use

this option and, in fact, customers are not even informed about the limit. This has no factual similarity to a credit arrangement.

Significantly, the record in this case contains no evidence as to how often the pay-to limit is used by the bank. Indeed, there is no evidence that it is ever used, even though it exists as a potential option programmed into the bad check processing system. Duvall answered Video Trax's questions regarding this option on a hypothetical basis, not stating what actually happens at the bank. It is clear, however, that Video Trax's account did not use the pay-to option and that usage of this option, if at all, is highly limited and requires special authority to implement. As the manager of the branch at which Video Trax maintained its account has testified, she had "no authority" to set such overdraft limits. The matrix is by far the dominant, if not the exclusive, aspect of the automated part of the bad check processing system.

Moreover, there is no evidence in the record to establish that the bank itself would consider any use of a pay-to option to be an "unofficial line of credit," as Video Trax concludes. In any event, the mere existence of the pay-to option for the use of certain bank managers in rare circumstances, especially because the customers would have no knowledge of its use, does not in any way convert the system involved in this case from a bad check processing system to a credit system.

(3) "Red herring" arguments that the "OD" fee constitutes interest:

(a) Plaintiff's Assertion: *NationsBank increased income through its application of service charges.*

This is irrelevant to the issue of whether such fees constitute interest. The fees are permitted under federal regulations and the Uniform Commercial Code. *See* 12 C.F.R. §7.4002; Section 674.303(2), Florida Statutes. Moreover, as Duvall pointed out in his deposition, planning for generation of income through bad check processing fees is no different than the City of Miami projecting income based upon speeding tickets.

(b) Plaintiff's Assertion: *The functional steps for processing an NSF check are different than for processing an OD check.*

This is irrelevant. Of course the procedures for handling bad checks are different after the bank has made a decision on whether to honor the item and label the bad check fee either an "OD" fee or an "NSF" fee, but there is in fact only one bad check processing system. Moreover, at any given moment after a bad check enters the system, it could be labeled as an honored (OD) item but in the very next moment it could just as readily be switched to be a return (NSF). For example, the bank's computer might tentatively identify a particular check as one to be honored based upon parameters set forth in the matrix, only to have that decision quickly overridden by a bank officer who decides to dishonor the check based upon other factors not considered by the computer. To focus on only those portions of the system containing the words "overdraft" and "OD," as plaintiff has done, completely misses at least half of the system. At the very end of the

process, the bad check is either returned or honored, but that is the very point of the entire system – to determine how to treat each bad check. There is only one process involved in this case, an integrated bad check processing system, and only one fee charged, regardless of how the check is categorized or labeled.

(c) Plaintiff's Assertion: *The bank sought to encourage rather than discourage customers to write bad checks to increase fee income.*

Video Trax's statement ignores the unrebutted evidence not only establishing the bank's intent to discourage bad checks by the fee but also demonstrating that the fee actually had the desired deterrent effect on Video Trax itself. Duvall specifically testified that NationsBank's bad check processing system and the bad check fee are intended to, and do, discourage overdrafting. Debbie Rowe, the branch manager where Video Trax had its account, testified that she took steps to discourage overdrafting, which included a refusal to waive the bad check processing fee except in situations where a customer had made a one-time mistake that was not likely to recur. Rowe even testified that she believed the imposition of numerous bad check processing fees (for both returned and honored checks) should have deterred Video Trax, for whom a special favor was being done. (This case comes within the ambit of the maxim: "No good deed shall go unpunished.")

In fact, the fees charged to Video Trax ultimately did have a deterrent effect. As Elalouf, one of the two owners of Video Trax testified, he was initially in charge of the plaintiff's checking account but that he is a "PR" man basically unconcerned with financial matters (including

his own personal accounts). He continued to write checks without knowing at any particular time whether he had sufficient funds in the company's account. He never bothered to open, let alone review, the monthly bank statements. He just wrote checks without much regard for the account balance even though he knew a bad check fee was being imposed for each check in excess of the account balance. (Significantly, Elalouf testified that he knew about the fee and how much it was at the time he opened the account based upon a document given to him at the time. He further testified that he received notices from the bank for each bad check imposing a fee "always in the same amount" regardless of whether the check was honored or returned.) As a result of his behavior, plaintiff incurred many bad check fees but did not pay any attention to them. When his partner, the "finance" man, finally reviewed all the bank statements, he saw the frequent overdrafting, added up the fees, and then promptly instituted controls to stop all overdrafts, including a requirement that both men sign all checks drawn on the company's account. From that point on, Video Trax, now a customer of another bank because NationsBank closed the Video Trax account, stopped presenting bad checks.

The record in this case undisputedly establishes that Video Trax was not a necessitous borrower who desperately needed money. Rather, it had a checking account that it negligently managed. There can be no doubt that in this case, the bad check processing fees ultimately had the deterrent effect desired by the bank and specified by the OCC in 12 C.F.R. §7.4002 as a fundamental justification for the existence of the fee. Discipline was finally imposed on the use of the company's checking account.

(d) Plaintiff's Assertion: *The opinion of Video Trax's expert supports its arguments.*

In short, bad facts lead to bad conclusions. The affidavit of Gene Coney offered by Video Trax does not purport to give any firsthand information regarding the NationsBank bad check processing system. All he offers is opinion based upon the information given to him by Video Trax. Indeed, his affidavit contains exactly the same arguments as the memoranda Video Trax submitted to the courts below, and it is a transparent attempt to give plaintiff's arguments some air of authority in light of the complete absence of case law to support them. Coney's opinions, like those of Video Trax, are deficient because they rely upon the plaintiff's highly selective view of the facts. Coney draws his conclusions without consideration of the NationsBank system for posting the standard, uniform bad check fee and without reference to the half of the system that handles "NSF" items. Because he analyzed only the "OD" side of the system, and misconstrued the OCC's regulations, Coney's conclusions, like those of Video Trax, cannot possibly be correct. Bad check processing fees, whether labeled "OD" or "NSF" are not interest.

REASONS FOR DENYING THE WRIT

The bad check processing fee at issue in this case, whatever name it might bear, is not usurious because it is not "interest" within the meaning of either federal or state law. As a highly respected commentator on bank law has concisely stated: "[C]harges that are imposed

whether a check is paid or bounced are not 'interest' for state usury law purposes. Instead, they are 'service fees.' This is the clear holding of all [the] cases that have looked at the issue. It is also the clear position of the OCC, to which the courts must defer. Most important, it is the only conclusion that makes sense." Barkley Clark, *The Law Of Bank Deposits, Collections And Credit Cards*, ¶3.01[4][b], at 3-49 (Rev. Ed. 1999).

Try as Video Trax might to deny it, the material facts in all of the previous cases deciding the present issue are the same as in this case: (1) the same dollar amount of fee was imposed whether or not the bank chose to honor the plaintiff's checks; (2) overdraft checks were not always honored, with a majority of the overdraft items being returned; (3) the fee was not compensation for any default or breach by the plaintiff of a condition upon which credit was extended; (4) presenting an overdraft item to the bank was not a breach of, or default on, the deposit agreement but, rather, an anticipated event for which plaintiff agreed to pay a flat, one-time, per-item bad check processing fee pursuant to the terms of the deposit agreement. *See First Bank v. Tony's Tortilla Factory*, 877 S.W. 2d 285 (Tex. 1994); *Nicolas v. Deposit & Guaranty National Bank*, 182 F.R.D. 226 (S.D. Miss. 1998); *Terrell v. Hancock Bank*, 7 F.Supp. 812 (S.D. Miss. 1998); *Beech v. Trust Mark National Bank*, No. 97 CV 187 GR (S.D. Miss. Jan. 13, 1998) (a copy is contained in the record below).

In its analysis of those cases, Video Trax misstates the factual record upon which the cases were decided. NationsBank explained every one of those misstatements in detail to both the district court and the Eleventh Circuit in the present case, including the filing of certified

copies of portions of the record in the *Nicolas* case before the Southern District of Mississippi. Thus, as a matter of both fact and law, the present decision does not conflict with any prior decisions on point, and it fully comports with both common sense and all current banking rules, regulations, and statutes.

A. There Is No Conflict With *Smiley*.

This Court's decision in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996), involved a credit card account. The present case involves a checking account, which is a deposit account rather than a credit account. The NSF, overdraft, and overlimit fees referenced in *Smiley* are the types of fees charged to a holder of a credit card who attempts to repay the outstanding balance on his card with a bad check or who exceeds the established credit limit on his card. The NSF or OD fee in the present case is the type charged to a deposit account customer who tries to take more money out of a checking account than it has on deposit. Although the names of the fees are confusingly similar, they are fundamentally different types of fees because the underlying transactions are fundamentally different. The *amicus* brief of the OCC filed with the Eleventh Circuit (and appended to this brief) clearly makes the distinction and explains the different regulations governing the two different types of transactions. *See* OCC Brief at 6-7 and Exhibit 1. This answers the "fundamental" question posed on page 22 of petitioner's brief: "What could the Comptroller of the Currency, in his rule-making posture, have been referring

to when it referred to 'over limit' fees within the context of 12 C.F.R. §7.4001(a)?"

In addition to focusing on an entirely different transaction than involved in the present case, *Smiley* also involved a diametrically opposite regulatory situation. In *Smiley*, state law *prohibited* the fee at issue, and federal law was held to pre-empt that prohibition so the fee could be exported by the national bank from the state in which it was located (and which did not prohibit the fee) into the prohibiting state where the bank wanted to do business. In the present situation, state law does *not* prohibit the fee, so federal law – consistent with the principle of allowing national banks to have the same advantages as state banks as set forth in Section 85 of the National Bank Act – also does not prohibit the fee.

Every court, including the district court below, that has directly considered the matter recognizes that *Smiley* does not control the situation in this case. *See Nicolas*, 182 F.R.D. at 231; *Terrell*, 7 F.Supp. at 817 n.1; *Beech*, 97 CV 187 GR at 7-8. The most current commentary on the matter also recognizes that the situation and holding in *Smiley* is irrelevant to the present case:

> *Smiley* held that late-payment fees imposed against delinquent bank credit cardholders constitute "interest" for purposes of allowing "exportation" of interest rates from the bank's home state to other states where cardholders reside. 12 C.F.R. §7.4001(a) codifies the *Smiley* decision by defining the term "interest" to include late-payment fees and NSF fees. However, as the OCC pointed out in its amicus brief in [*Nicolas*], that part of the regulation is intended to include such fees as "interest" only

> when they are imposed in connection with a standard extension of credit. In *Smiley* . . . the late fees were imposed on cardholders who were borrowing under an established open-end line of credit. Both *Smiley* and §7.4001(a) allow "exportation" of such fees, to the benefit of the bank. By contrast, NSF fees on deposit accounts do not involve any "exportation" issue, they are not imposed in connection with a preexisting extension of credit, and their purpose is simply to compensate the bank for the cost of handling checks presented against insufficient funds. They are bad-check processing fees, not interest.

Clark, *supra*, at 3-48. The decision in the present case does not, therefore, conflict with the decision in *Smiley*.

B. There Is No Conflict With Any Decision By Any Court Of Appeals Or Other Court.

There are no court of appeals decisions directly on point, and all of the district court and state court decisions on point are in accord with the decision in this case. The cases cited in Video Trax's brief address a more general, and fundamentally irrelevant, proposition that "a whole line of decisions by courts throughout the country . . . have broadly recognized that flat fees, like periodic interest rates, are interest as well," or they address similarly general principles of law. None of the cases cited by Video Trax address the specific issue in this case of whether a bad check processing fee imposed on a demand account is "interest." Not one of the cases cited by Video Trax even involves an NSF/OD fee charged to a checking account, let alone discusses whether or not such a fee constitutes "interest." In fact, *all* of the cases cited

by Video Trax in support of its assertion unambiguously involve credit arrangements and fees related to such clear-cut extensions of credit. None involve a checking account, an overdraft check, or a bad check processing fee.

C. The Issue In This Case Is Essentially A Simple State Usury Law Question.

The OCC and all the courts deciding the matter have determined that bad check processing fees do not constitute "interest" under federal law. Nonetheless, as a matter of federal law, and contrary to Video Trax's implication, state law also plays a critical role in the determination of what constitutes "interest" in circumstances such as involved in the present case. The *Nicolas* court put the matter succinctly: "[Even] assuming *arguendo* the NSF fee is deemed to be interest as defined by the National Bank Act, the remedial provisions of the Act are not triggered unless the fee also violates [state] usury laws." 182 F.R.D. at 232. The *Nicolas* court premised its holding on the OCC's *amicus* submission in that case. *Id.* at 231. The OCC explained to the court that under the agency's existing rules and regulations, if a fee (such as a bad check processing fee) is not prohibited or limited by the law of the state in which a national bank is located or doing business, then the fee can be charged by the bank and does *not* constitute "interest" under the federal statute. Specifically, the OCC stated:

> In point of fact, the NSF charges in issue here – charges that are related solely to a deposit account and not at all to the lending of money or the breach of an agreement for the

> lending of money – do not constitute "interest" within the meaning of 12 U.S.C. §85. *See* 12 C.F.R. §7.4001(a). If, however, they did, Plaintiff's argument would still necessarily fail. . . . *If, as is the case with the NSF charges here, state law does not prohibit or limit the charge: (a) national banks may levy the charge, and* (b) state law determines whether or not the charge is included in the calculation which determines whether the bank has charged "interest" in excess of the limitation (if any) imposed by the state on total "interest." See 12 C.F.R. §7.4001(c).
>
> *Here, as will be shown below, Mississippi does not count the subject NSF charges in determining if a bank has charged interest in excess of the statutory maximum. Therefore, national banks need not do so either, whether or not the charges constitute "interest" under the federal statute.* This point is clearly set forth in the federal regulation. *Id.*; 61 Fed. Reg. 4,858 (1996).

OCC *Amicus* in *Nicolas* at 4-6 (underlined emphasis is in the original; emphasis in italics is added).

The OCC's position as presented to the Mississippi district court is grounded in the agency's existing rules. The OCC has itself explained that the rule (i.e., 12 C.F.R. §7.4001(a)) which it promulgated to define NSF fees and other charges as "interest" (the rule relied upon by the Supreme Court in *Smiley*) has limited application. *See* 12 C.F.R. §7.4001(c); 61 Fed. Reg. 4,849, 4,858-59 (February 9, 1996); OCC *Amicus* at 2-3. According to the OCC, its definition applies when a national bank located in one state allowing such fees or charges wants to "export" those same fees or charges for purposes of a credit transaction into another state that does not allow the fees or

charges. *Id.* As the OCC has specifically explained, however, by rule, comment, and *amicus* brief, the definition in Section 7.4001(a) does *not* apply for purposes of determining whether a particular fee or charge is to be included in a state's calculation of interest for usury purposes. *Id.* Even more specifically, the OCC has explained that if a state excludes NSF/OD fees (or late fees or other fees listed in Section 7.4001(a)) when calculating the maximum interest under its usury laws, then federal law allows national banks to charge those fees. *Id.*

The OCC's regulation contained in Section 7.4001 expressly states on its face, in subsection "(c)," that the definition contained in subsection "(a)" does not control state law usury calculations. Specifically, subsection "(c)" provides:

> (c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees [or NSF/OD fees] are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees [or NSF/OD fees], then a national bank located in that state may charge late fees [or NSF/OD fees] to its intrastate customers. . . . *[T]he late fees [or NSF/OD fees] would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees [or NSF/OD fees] when calculating the maximum interest that lending institutions may charge under those limitations.*

12 C.F.R. §7.4001(c) (emphasis added).

In its comments published at the time Section 7.4001 was promulgated, the OCC elaborated on this formal rule that the federal definition was intended to facilitate "exportation" of fees and charges to assist national banks "with respect to interstate lending operations" but was not intended to affect state law usury calculations such as involved in this case. 61 Fed. Reg. 4,849, 4,858-59 (February 9, 1996). In fact, the OCC modified subsection "(b)" of the original version of the regulation and added subsection "(c)" in its entirety to the final version of the regulation because the OCC "received comments from Arkansas trade associations and the Arkansas congressional delegation expressing concern that the proposed Federal definition of 'interest' might be misinterpreted to require the inclusion of certain charges that are 'interest' under the Federal definition, but not so under Arkansas law, when calculating the maximum effective yield permitted by Arkansas law." *Id.* at 4,858. As the OCC explains:

> Section 7.4001(b) clarifies that, under the ruling (and 12 U.S.C. 85), one looks to state law to determine what lending charges are permitted for the most favored lender, and thus, also for national banks under 12 U.S.C. 85. *However, the Federal definition of "interest" generally does not affect state law definitions of "interest" or the manner in which state law calculates the amount of interest being charged.*

Id. (emphasis added). And as the OCC further explains:

> The final ruling addresses the concern raised by the Arkansas commentators regarding the effect of the Federal definition of interest on state law. The OCC has added to §7.4001 a new paragraph (c) that includes *a clarifying sentence*

> *confirming that the Federal definition of the term interest does not change a state's definition of interest (nor how the state definition of interest is used) solely for purposes of state law.*

Id. (emphasis added).

Florida has a statute that specifically excludes any bad check fees in certain overdraft financing arrangements from the state's definition of interest for purposes of the usury laws. Section 655.954(1), Florida Statutes, provides that "notwithstanding any other provision of law" [which includes, of course, Florida's usury law], "a financial institution shall have the power to make loans or extensions of credit to any person on a credit card *or overdraft financing arrangement* and to charge, in any billing cycle, *interest* on the outstanding amount." (Emphasis added). Section 655.954(2) defines "interest" as "those charges considered a finance charge under the federal Truth in Lending Act, 15 U.S.C. §§1601 et seq., and the associated regulations which are in effect as of June 30, 1992." TILA regulations exclude bad check processing fees, such as in this case, from the definition of "interest." Thus, Florida law excludes such fees from the computation of interest for usury purposes.

Exclusion of bad check processing fees from the definition of interest in TILA is well established. The Eleventh Circuit, for example, albeit in a different context, has identified the "associated regulations" for determining what constitutes a "finance charge" under the Truth in Lending Act (TILA): "To decide whether a particular loan . . . expense constitutes a 'finance charge' under TILA, courts must consult the statute . . . and the applicable portion of Regulation Z, 12 C.F.R. §226.4 . . .

promulgated by the Federal Reserve Board." *Johnson v. Fleet Finance, Inc.*, 4 F.3d 946, 949 (11th Cir. 1993). The regulation referenced by the Eleventh Circuit – Reg. Z – specifically *excludes* "[c]harges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing." 12 C.F.R. §226.4(c)(3).

In this case, it is established beyond question that Video Trax had no agreement with NationsBank to pay all overdraft items. To the contrary, the deposit agreement between Video Trax and the bank expressly provided that the bank "is not obligated to pay an item presented if [Video Trax's] account does not contain sufficient collected funds." NationsBank, at all times, had complete discretion whether to pay or return any potential overdraft items. In fact, more often than not, the bank returned Video Trax's bad checks. On these facts, it is clear that the NSF/OD fee in this case cannot be considered interest in Florida by virtue of the provisions of Section 655.954. Under OCC regulations, this Florida law controls.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 99-4007

VIDEO TRAX, INC., a Florida corporation on behalf of itself and all other persons and entities similarly situated,

Plaintiff-Appellant,

v.

NATIONSBANK, N.A., a national banking association,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

BRIEF FOR THE OFFICE OF THE COMPTROLLER OF THE CURRENCY AS *AMICUS CURIAE*

INTEREST OF THE *AMICUS CURIAE*

The Comptroller of the Currency ("Comptroller" or "OCC") is the primary regulator of the nation's federally-chartered banks. *See* 12 U.S.C. §§ 21 et seq. The Comptroller charters, regulates, and supervises approximately 2,500 national banks and 66 federal branches and agencies of foreign banks in the United States, accounting for nearly sixty percent of the nation's banking assets. Its mission is to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States.

In light of its mission, the Comptroller has an obvious interest in assuring that national banks are able to exercise the powers granted to them by Congress, including the power to make loans, charge interest on these loans, receive deposits, and charge fees for servicing customers' deposit accounts. The Comptroller's particular interest in this case is the proper interpretation and application of the National Bank Act, specifically, 12 U.S.C. § 85, its implementing regulation, 12 C.F.R. § 7.4001 (1999), and the interplay between the federal statutory scheme and state usury laws.

STATEMENT OF THE ISSUES

The only issue before the Court is whether the flat fee charged by NationsBank constitutes "interest" for purposes of 12 U.S.C. § 85 and 12 C.F.R. § 7.4001(a), when such fee is assessed by NationsBank whether or not it honors a check presented against insufficient funds.

STATEMENT OF THE CASE

The OCC hereby adopts, in its entirety, the Statement of the Case contained in the Appellee's Brief, filed on May 6, 1999. Appellant Video Trax, Inc. ("Video Trax") a Florida corporation, held a Simple Analysis Business Checking account at appellee NationsBank, N.A. ("NationsBank"). Under the account agreements governing the parties' obligations, Video Trax agreed in writing to pay a flat fee whenever a check written and presented for payment on the Video Trax account exceeded the account balance. There was no relation between the flat fee charged and the amount of the check, whether any

overdraft was permitted, or the duration of any such overdraft. As to each check presented when insufficient funds existed in Video Trax's account, the deposit agreements gave NationsBank the option to either honor or dishonor the check.

In those instances when NationsBank chose to honor the check, an overdraft was permitted to exist in Video Trax's account. NationsBank would charge the flat fee, designated as an "OD" fee in those instances, and assess interest against the average daily overdrawn account balance. Video Trax challenges only the flat fee, and not the interest rate charged against the average daily overdrawn account balance.

In those instances when NationsBank chose not to honor the check, it was returned unpaid. NationsBank would charge the same flat fee for a check it dishonored as for a check it honored. The only difference is that the fee for the dishonored check would be designated as a "not sufficient fund" or "NSF" fee. No overdraft would be permitted and so no overdraft interest would be charged.

SUMMARY OF ARGUMENT

The fees at issue here, whether designated as "OD" or "NSF" fees, were not usurious because they were not "interest" within the meaning of either federal or state law. They were not "interest" within the meaning of 12 U.S.C. § 85 or 12 C.F.R. § 7.4001(a) because they were charges related solely to a deposit account and not at all to the lending of money or the breach of an agreement for the lending of money. Nor were the fees "interest" under

Florida law, specifically, Fla. Stat. Ann. § 687.03(2)(b) (West Supp. 1998), pursuant to which the calculation of unlawful rates of interest "shall apply only to loans and advances of credit." Neither the OD nor NSF fees were charged for receipt of a loan or were incident to or a condition for the extension of credit. It is clear from the undisputed facts that the OD/NSF fees were bad check processing fees, not interest on extensions of credit.

ARGUMENT

Appellant contends that the OD/NSF fees in this case constitute "interest" under both federal and state law. Neither contention is correct. Imposition of an NSF fee without regard to whether NSF items are paid is not interest and does not violate the National Bank Act or Florida usury law. *See Nicholas v. Deposit Guaranty National Bank*, 182 F.R.D. 226, 231 (S.D. Miss. 1998); *Beech v. Trustmark National Bank*, No. 1:97cv187GR, slip op. (S.D. Miss. Jan. 13, 1998); 12 C.F.R. § 7.4001(a) (1999).

I. The Fees Were Not Interest Under Federal Law

The term "interest" is defined under the National Bank Act as follows:

> The term "interest" as used in 12 U.S.C. § 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability:

> numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, cash advance fees, and membership fees. . . .

12 C.F.R. § 7.4001(a). Because the fees at issue were not imposed in connection with a *credit transaction*, they were not interest as defined by the National Bank Act. *Nicholas*, 182 F.R.D. at 231. As was the case in *Nicholas*, it is clear that the fees arose from the terms of the depository agreements.

The definition of "interest" in § 7.4001(a) is intended to define "interest" for purposes of determining if a particular charge is subject to section 85. Charges that fall within the federal definition of "interest" are subject to section 85 and its "most favored lender" and exportation rules. 61 Fed. Reg. 4,858 (1996) (preamble to OCC's final rule, revising 12 C.F.R. Part 7, Interpretive Rulings). An NSF charge is "interest" subject to the statutory usury ceiling when it is assessed in connection with an *extension of credit*. Otherwise it would not meet the basic criterion of being "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." This did not happen here. The NSF/OD charges at issue here were assessed whether or not the Bank chose to honor a check drawn against insufficient funds; the NSF charge results directly from the customer's act of presenting a check for payment upon insufficient funds. In other words, the NSF charge is a direct result of the customer's action.

The fees were not compensation for an extension or line of credit because the same fee was imposed whether

or not NationsBank chose to honor Video Trax's checks presented on an account with insufficient funds. Nor were the fees compensation for "any default or breach" by Video Trax of a condition upon which credit was extended. For one thing, credit was not always extended; some of Video Trax's NSF checks were honored, others were not. *Video Trax, Inc. v. NationsBank, N.A.*, No. 97-1586-CIV-GOLD (S.D. Fla. Dec. 10, 1998), slip op. at 4.

The situation whereby an NSF charge is treated as interest under section 7.4001(a) is illustrated in OCC Interpretive Letter #817 (Jan. 7, 1998) (Attached as Exhibit 1). That letter concerned an NSF fee that the lending bank imposed when the borrower's check, presented in connection with an outstanding credit balance, bounced.

It is plain from the definition of "interest" in the first sentence of 12 C.F.R. § 7.4001(a) that the term "NSF fees," which is given as an illustrative example, was intended to cover certain fees that a national bank charges that arise out of its lending relationship with a customer, and not service fees arising out of its deposit relationship with a customer.[1] Video Trax's obligation to repay arose in connection with its failure to deposit funds and not pursuant to the "simple lending of money." *Nicholas*, 182 F.R.D. at 234, citing *First Bank v. Tony's Tortilla Factory, Inc.*, 877 S.W.2d 285, 287 (Tex. 1994).

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[1] "Interest" is defined as a "charge made to a borrower by the lender for the use of money," Charles J. Woelfel, *Encyclopedia of Banking & Finance* 608 (10th ed. 1994), and "money paid for the use of borrowed funds." G. Donald Jud & Charles J. Woelfel, *The Desktop Encyclopedia of Banking* 220 (1988). The OD/NSF fees at issue do not fit either of these definitions.

Thus, the fees at issue do not fall within the federal definition of interest set forth in 12 C.F.R. § 7.4001(a). Instead, they are addressed by a separate federal regulation, 12 C.F.R. § 7.4002 (1999), which reads as follows:

> (a) Customer charges and fees. A national bank may charge its customers non-interest charges and fees, including deposit account service charges . . .
>
> (b) Considerations. The establishment of non-interest charges and fees, and the amounts thereof, is a business decision to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A bank reasonably establishes non-interest charges and fees if the bank considers the following factors, among others:
>
> > (1) The cost incurred by the bank, plus a profit margin, in providing the service;
> > (2) The deterrence of misuse by customers of banking services;
> > (3) The enhancement of the competitive position of the bank in accordance with the bank's marketing strategy; and
> > (4) The maintenance of the safety and soundness of the institution.
>
> (c) Interest. Charges and fees that are "interest" within the meaning of 12 U.S.C. § 85 are governed by § 7.4001 and not by this section.

As the court below held, the charges at issue here are precisely those described in 12 C.F.R. § 7.4002. *Video Trax, Inc. v. NationsBank, N.A.*, slip op. at 16.[2]

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[2] Moreover, the court below concluded that the fees "substantially satisfy the reasonableness factors set forth in 12

II. The Fees Were Not Interest Under State Law

Even assuming, *arguendo*, the NSF fee is deemed to be "interest" as defined by section 85, the remedial provisions of the Act, 12 U.S.C. § 86, are not triggered unless the fee also violates Florida usury law. *Nicholas*, 182 F.R.D. at 232. As addressed in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996), the National Bank Act allows a national bank to charge "interest at the rate allowed by the laws of the State . . . where the bank is located."

12 U.S.C. § 85.

As noted, the definition of "interest" in § 7.4001(a) is intended to define "interest" for purposes of determining if a particular charge is subject to section 85. Charges that fall within the federal definition of "interest" are subject to section 85 and its "most favored lender" and exportation rules. 61 Fed. Reg. 4,858 (1996). Section 7.4001(b) clarifies that one looks to state law to determine what lending charges are permitted for the most favored lender, and thus, also for national banks under section 85. However, the federal definition of interest in § 7.4001(a) generally does not affect state law definitions of "interest" or the manner in which state law calculates the amount of interest being charged. *Id.* 12 C.F.R. § 7.4001(c) (1999) illustrates this point using late fees, a type of fee included in the federal definition of interest in 12 C.F.R. § 7.4001(a), as an example.

C.F.R. § 7.4002(b)." Slip op. at 17-18. *See also Wallace v. Bank of Bartlett*, 55 F.3d 1166 (6th Cir. 1995), *cert. denied*, 516 U.S. 1047 (1996); *Nicholas*, 182 F.R.D. at 231.

> For example, if late fees are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the national bank is located. *However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.* (emphasis added).

A court, therefore, should look to Florida law to determine whether the OD/NSF fee falls within the framework of Florida's statutory scheme regulating finance charges and interest rates. *See Nicholas*, 182 F.R.D. at 232. As the district court ruled, applying Florida law, the OD/NSF fee charged by NationsBank for the presentment of checks against an overdrawn account is not interest for the purpose of determining whether a transaction is usurious. *Video Trax, Inc. v. NationsBank, N.A.*, No. 97-1586-CIV-GOLD (S.D. Fla. Dec. 10, 1998), slip op. at 19. Contrary to Video Trax's assertion, Florida's formula for calculating interest on loans and credit "belies the fact that [the OD/ NSF] fees are a subterfuge for excessive interest." *Id.* The rate of interest on Florida transactions is:

> alculated by first computing the advance or forbearance as a percentage of the total stated amount of such loan. . . . This percentage shall

> then be divided by the number of years, and fractions thereof, of the loan . . . according to its stated maturity date, without regard to early maturity in the event of default. The resulting annual percentage rate shall then be added to the stated annual percentage rate of interest to produce the effective rate of interest for purposes of this chapter.

Fla. Stat. Ann. § 687.03(3) (West Supp. 1998). The clear language of section 687.03(3) refers to the particular term stated on the face of a loan document. The statute explicitly states that the calculation of unlawful rates of interest "shall apply only to loans and advances of credit." Fla. Stat. Ann. § 687.03(2)(b) (West Supp. 1998). Thus, Video Trax's usury claim cannot stand unless NationsBank's fees were a charge for receiving a loan or were incident to or a condition for the extension of credit. As in *Nicholas*, it is clear that the fees were not imposed pursuant to a lending transaction. To the contrary, the fees were imposed regardless of whether or not NationsBank honored the insufficient funds checks and permitted an overdraft to exist in the account. *See Nicholas*, 182 F.R.D. at 232-33. Simply, they were fees to compensate the bank for services rendered in processing an account holder's bad checks.

CONCLUSION

For the reasons set forth in the foregoing, the OD/NSF fees were not usurious because they were not "interest." Accordingly, this Court should affirm the decision below.

CERTIFICATE OF COMPLIANCE

We hereby certify in accordance with FRAP 32(a)(7)(C) that this brief complies with the type-volume limitation specified in Rule 32(a)(7)(B). Specifically, it contains 2,573 words within the sections specified by 11th Cir. R. 28-1.

Respectfully submitted,

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EXHIBIT 1

[LOGO]

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

January 7, 1998

Interpretive Letter #817
February 1998
12 U.S.C. 85

Dear [ ]:

This is in response to your letter of December 10, 1997, seeking clarification as to whether certain fees levied by the bank in connection with its credit card accounts constitute "interest" for purposes of 12 U.S.C. § 85 (section 85) as that term is defined in 12 C.F.R. § 7.4001(a) (section 7.4001(a)). If the fees constitute "interest" and if they are permitted by the state where the national bank is located, then section 85 provides authority to the national bank to charge those fees to borrowers who reside in another state even if that other state prohibits the imposition of a particular fee in connection with credit card loans.[1]

The fees about which you inquire are late fees and non-sufficient funds (NSF) fees imposed by the bank after

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[1] *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). The bank about which you inquire is an intrastate bank – that is, its main office and any branch offices are located only in one state. Consequently, no issue arises about which state's interest rate law applies to loans made by an interstate national bank.

either the bank or the customer notifies the other that they are terminating credit privileges but before the outstanding credit balance is paid off. As you describe the facts, late fees are charged whenever a customer makes the minimum monthly payment after the date on which it is due and NSF fees are imposed whenever a borrower's check is presented in payment of an amount owed by the borrower to the bank and the check is returned by his or her bank.

Section 7.4001(a) specifically provides that late fees and NSF fees are considered interest for purposes of section 85 and, if permissible under the law of the state where the bank is located, may be charged without regard to the state of the residence of the borrower.[2] You are concerned, however, about the possible impact of a recent OCC letter addressing fees charged by a bank when it rejects items presented by a customer to draw against a home equity account following the termination of the account. The letter held that these fees were not "interest" for purposes of section 85 because "no debtor/creditor relationship exists at that point. . . ."[3] As that letter noted, under Regulation Z, banks may, under certain circumstances, terminate home equity lines of credit and demand repayment.[4]

---

[2] 2 C.F.R. § 7.4001(a). This regulation has been upheld by the Supreme Court in *Smiley v. Citibank (South Dakota) N.A.*, 135 L.Ed.2d 25 (1996).

[3] OCC Interpretive Letter No. 803, October 7, 1997, *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,250.

[4] *Id.* at fn. 4.

However, the circumstances you describe differ in two respects. First, even after termination, the account retains an outstanding loan balance, incurred prior to termination, which the customer must repay. Second, you are not asking about fees charged in connection with impermissible new draws against the terminated account as described in Interpretive Letter No. 803, but about late fees and NSF fees charged in connection with repaying the outstanding balance that existed before termination of the account. Under these circumstances, the debtor/creditor relationship between the bank and customer remains; consequently late fees and NSF fees charged in connection with the repayment of the existing balance continue to be considered interest under sections 85 and 7.4001(a). Nothing in Interpretive Letter No. 803 compels a different conclusion.

I hope that this has been responsive to your inquiry.

Sincerely,

/s/

Julie L. Williams
Chief Counsel

CERTIFICATE OF SERVICE

This is to certify that on this 27th day of May, 1999, a copy of the Comptroller of the Currency's Motion for Leave to File a Statement of Interest as *Amici*, as well as the Brief for the Office of the Comptroller of the Currency as *Amicus Curiae*, has been served, by first class mail, on:

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